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INTERNATIONAL NATURAL RUBBER AGREEMENT, 1987

AUGUST 3 (legislative day, AUGUST 1), 1988.—Ordered to be printed

Mr. PELL, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Treaty Doc. 100-9]

The Committee on Foreign Relations, to which was referred the International Natural Rubber Agreement, 1987, done at Geneva, March 20, 1987, and signed on behalf of the United States on August 28, 1987, having considered the same, reports favorably thereon without amendment and recommends that the Senate give its advice and consent to ratification thereof.

PURPOSE

The International Natural Rubber Agreement (INRA), 1987 is a multilateral commodity agreement designed to stabilize natural rubber prices without interfering with long-term market trends and to foster expanded natural rubber supplies at reasonable prices.

COMMITTEE ACTION

The International Natural Rubber Agreement was transmitted to the Senate on October 20, 1987. At its business meeting on July 27, 1988 the committee voted, by voice vote, to report the agreement favorably to the Senate with the recommendation that the Senate give its advice and consent to ratification.

BACKGROUND

The INRA 1987 is a follow-on agreement to the International Natural Rubber Agreement, 1979. This first agreement was greeted with some skepticism by the U.S. rubber traders and consumers; however, initial skeptics now concur that the 1979 agreement has proven extremely valuable in stabilizing natural rubber prices without interfering with underlying market forces. Supporters of

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the agreement include the Rubber Manufacturers Association and the Goodyear Tire & Rubber Company.

Purpose and Summary of the International Natural Rubber Agreement

As stated earlier, the International Natural Rubber Agreement is a multilateral commodity agreement to stabilize natural rubber prices and to promote a reasonably priced natural rubber supply. The operative mechanism in the agreement is the sale or purchase of rubber from a rubber buffer stock, not to exceed 550,000 metric tons, to defend rubber prices within a predetermined but flexible price range.

Operations of the buffer stock are controlled by the buffer stock manager who bases his operations on guidelines described below. The agreement establishes a reference price for rubber, based on long-term market trends, as well as a market indicator price which is composite, weighted average of daily prices for certain types of natural rubber at the Kuala Lumpur, New York, London, and Singapore markets.

As long as the daily market indicator price remains within a range of 15 percent of the reference price, the buffer stock manager does not intervene in the market. When the indicator price lies within a range of 15 to 20 percent above and below the reference price, the buffer stock manager may intervene to stabilize prices. When the indicator price exceeds or falls below the reference price by 20 percent or more, the manager must intervene to stabilize prices.

In order to remain responsive to long-term market price trends, the rubber agreement provides for a review and adjustment of the reference price every 15 months. This review period is shorter than that in the previous agreement and thus provides for more frequent adjustments of the reference price to reflect long-term market forces. Further, the new agreement provides for mandatory minimum adjustments in the reference price, if certain criteria are met, whereas in the previous agreement these changes were subject to review.

In addition to the provisions relating to price stabilization, the agreement also contains provisions obligating producer nations to undertake to maintain a continuous availability of natural rubber supplies. Consumer nations are obligated to maintain open access to their markets for natural rubber.

The rubber agreement is administered by the International Rubber Organization and its governing body, the International Rubber Council, based in Kaula Lumpur. There are two catagories of members in the organization, rubber exporters and rubber importers. Each block has 1,000 votes subdivided among the members on the basis of their share of that market; the United States share of the importers vote is approximately 14 percent. All decisions by the council must be approved by a majority vote, of both exporting and importing members, protecting each block's interests.

The new agreement will remain in force for 5 years and may be extended for 2 more years by vote of the council.

COSTS

Based on projections of future trends in natural rubber prices, the administration does not anticipate that additional funding will be needed for U.S. participation in INRA. Under the terms of the previous agreement (INRA 1979), signatories to the agreement may roll over their share of the value of the buffer stock at the conclusion of that agreement into the proposed 1987 agreement. The current value of the United States' share of the INRA 1979 buffer stock is approximately $57 million.

In addition to the buffer stock costs, signatories also must bear the administrative costs of the agreement in proportion to their representation on the council. With future annual estimated costs of $1.4–$1.5 million, the United States share of these costs will be approximately $200,000 to $210,000 per year.

EXECUTIVE BRANCH COMMENTS

THE U.S. TRADE REPRESENTATIVE,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, DC.

Hon. CLAIBORNE PELL,
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Since the Office of the United States Trade Representative is responsible for directing and managing U.S. commodity policy and for negotiating U.S. participation in commodity agreements, I am submitting, on behalf of the administration, a background statement of our position supporting U.S. participation in the International Natural Rubber Agreement, 1987. We thought that the information contained in this document would be helpful to you and your colleagues as you consider the ratification of this Agreement.

Please feel free to contact me at 395–3204 if you have any questions.

Sincerely,

ALAN F. HOLMER
(Acting for Clayton Yeutter).

Enclosure.

Mr. Chairman, I am pleased to submit this statement in support of the administration's view that the United States should participate in the second International Natural Rubber Agreement (INRA 1987). We believe U.S. membership in the first agreement (INRA 1979) served U.S. foreign policy and economic interests. Membership in the successor agreement would provide continued benefits both in terms of U.S. relations with natural rubber producers and with respect to supply availability and price stability for our industry.

Although skeptical as to the value of commodity arrangements, particularly those with economic provisions, the administration has responded to producer concerns and, on a case-by-case basis, has been prepared to participate in agreements which respond to market forces, which

have carefully defined functions and controls, and which are appropriately funded by producers and consumers. Experience shows that most arrangements with economic measures have not worked and often result in market disruptions by attempting to support prices at unrealistic levels. In contrast, however, the rubber agreement has been successful in moderating price fluctuations through a market-oriented mechanism that operates consistent with market trends. In addition, it has been adequately funded and has promoted better commercial relationships among exporting and importing countries.

The first agreement, in which all major producers and consumers participated, lasted from October 1980 to October 1987. Work on a successor agreement began in early 1985. However, because the negotiations were protracted, agreement was not reached in time to permit countries to complete ratification procedures before the expiration of INRA 1979.

As with INRA 1979, INRA 1987 would last for 5 years, with the possibility of extension for up to 2 more years. Countries accounting for at least 75 percent of world trade must ratify and be able to meet their full financial commitments before the new agreement can enter into force provisionally. There are good prospects this will occur in the fall since countries accounting for this level of participation (i.e., all major members) have signed the agreement indicating their intention to ratify. (Malaysia, Indonesia, Japan, and China have already ratified.)

As a practical matter, however, without U.S. membership the agreement is unlikely to become operational because of the percentage requirement and because of the impact of our decision on other countries.

As for budgetary considerations, the United States share of INRA 1979 assets exceeds our initial contribution and we currently estimate that there will be no requirement for additional U.S. contributions to INRA 1987's buffer stock account. If, in the future, we determine additional funds are required, they will be requested through the normal appropriations process.

Foreign Policy Considerations

Responding to the destabilizing impact on their economies of wide swings in commodity prices, developing countries have sought agreements which would moderate those price changes and ensure levels of income for key economic sectors. Economic stability is also critical to the U.S. desire for the development of mature political institutions throughout the developing world.

The United States played a key role in INRA 1979 and in the negotiation of INRA 1987, achieving most of our objectives. Other participants in that process, therefore, believe failure of the United States to join the agreement would be tantamount to demonstrating the United States had not negotiated in good faith.

In making the decision to enter into the negotiations leading to the International Natural Rubber Agreement, the administration was mindful of the interests and concerns of key ASEAN countries, (Malaysia, Indonesia, and Thailand) which account for nearly 90 percent of natural rubber exports, as well as a number of other countries in Asia, Africa, South Asia, and Latin America. Other key importing countries, notably the members of the EEC, Japan, China, and the Soviet Union responded similarly.

Participation in the agreement has direct benefits to U.S. industry and consumers as well through more secure supplies at stable prices, issues which are discussed in detail later in this paper.

Background

The main purpose of both INRA 1979 and its successor INRA 1987 is to stabilize world natural rubber prices within a pre-agreed price range, and to ensure adequate supplies. The sole mechanism for stabilizing the flow of rubber and consequently prices is through purchases or sales from a natural rubber buffer stock of up to 550,000 metric tons. To keep prices within the desired range, the buffer stock manager buys (or sells) rubber in order to increase (or decrease) the market price. There are no production or export quota provisions, and producers have agreed to avoid such provisions to the fullest extent possible.

Although INRA 1979 and INRA 1987 are quite similar, the United States successfully sought a number of improvements which have been incorporated in the latter agreement. Included are quicker and more automatic adjustments of the price range to adapt to changing market conditions and elimination of all borrowing provisions, reducing the risk of financial losses and complications.

Decisions on activities of the organization are made by a council, composed of all members of the agreement. Votes and costs are split equally between exporters and importers with individual country shares within groups allocated on the basis of trade share. As the world's largest natural rubber importer, the United States has about 14 percent of the total vote and bears the same share of the financial burden. Among importers, the European Community, which votes as a block, is second with 12.5 percent of the vote. Total INRA 1979 contributions to the buffer stock amounted to about $360 million. There were no significant problems in obtaining the timely payment from members.

INRA's market stabilizing activities are determined by a "reference price," which is based on the long-term trend in world market prices. For the first 400,000 metric tons of the buffer stock, the operational rule of the buffer stock is to keep the market price within ±20 percent of the reference price. For the last 150,000 metric tons of the stock (i.e., the contingency stock), the overall goal of the buffer stock manager is to maintain the market price between INRA's floor and ceiling price, which were set at ±29 percent of the original reference price.

When prices are within ±15 percent of the reference price they are in a "non-intervention" zone and no buying or selling takes place. When market prices are between 15 and 20 percent higher

or lower than the reference price the buffer stock manager may intervene on a discretionary basis. If market prices are at or beyond ±20 percent of the reference price the buffer stock manager is required to intervene in order to stabilize the price.

With regard to the automatic adjustment of the price range, if, for instance, average market prices of the previous 6 months are below (above) the non-intervention zone, then the price range will be lowered (raised). Such price range revisions can occur every 15 months, rather than at 18-month intervals as in INRA 1979.

In addition, the price range will be reviewed after each 100,000 metric tons change in the stock to determine if operations should be modified or the price range revised. When the buffer stock increases by 300,000 tons, another automatic adjustment is made downward in the price range. This occurred during INRA 1979 in August, 1985, when the price range was lowered by 3 percent as the buffer stock reached 300,000 metric tons.

It is important to reiterate that some of the key changes between INRA 1979 and INRA 1987 are the strengthening of the price range revision provisions. These changes build even more market orientation into the new agreement, by allowing the price range to adjust to changing market conditions more quickly and to a greater degree than under INRA 1979.

At the conclusion of the first agreement, about 350,000 metric tons of natural rubber were in the buffer stock. To preserve its value until a new agreement would enter into force, the INRA 1979 council authorized limited sales from the buffer stock at prevailing prices to finance storage and related incidental costs. In September 1987, subsequent to the council decision, the buffer stock manager, responding to an unexpected increase in the price of natural rubber into the discretionary selling range, began sales to stabilize the price, consistent with the terms of the agreement. These sales have continued until the present. As a result, stocks have been reduced from a high of nearly 370,000 metric tons to less than 70,000 metric tons today. Indications are these sales were successful in preventing greater price increases. However, the stock may be fully depleted within the next several weeks. Thus, the buffer stock purchased 370,000 metric tons in the periods of low prices in the early-mid 1980's, and has sold almost all of the stock to increase available supplies in a high priced market during the last year.

The Role of Natural Rubber in the U.S. Economy

Before discussing how the rubber agreement benefits the United States, it will be useful to describe the role of natural rubber in our economy. The United States is the world's largest consumer of natural rubber, using it in a broad range of commercial and strategic applications. About four-fifths of natural rubber demand in the United States is from the transportation sector, particularly in tires. An estimated 167 million passenger car tires and 35 million truck tires were produced in the United States last year. Over 90 percent of these passenger car tires were radials, which require more natural rubber than do bias-ply tires. The percentage of U.S. passenger car tires which are radials has gradually increased in the past 15 years to this high level. The percentage of truck tires

which are radials has also been steadily increasing. Natural rubber provides essential properties for tires, such as high resistance to abrasion, cracking, and heat.

Natural rubber is also used in a wide range of general industrial applications due to its unique properties. Further, there are no substitutes for natural rubber latex, which accounts for about 10 percent of our natural rubber imports, in the production of medical gloves and condoms.

Natural rubber's strategic applications include its use in jet aircraft tires and in other military equipment. Aircraft tires are nearly 100 percent natural rubber, since resistance to heat build-up on impact is of the utmost importance. There is no known substitute for natural rubber in this application.

Since the United States does not produce natural rubber, we must import it. Last year net U.S. imports of natural rubber were 814 thousand metric tons, valued at $682 million. Although in certain instances synthetic rubber can be readily substituted for natural rubber, this is not always the case. It has been estimated that in 25–30 percent of the synthetic and natural rubber market, natural rubber provides technical advantages (such as heat resistance) over synthetic rubber. Clearly, since the United States must import natural rubber for many important applications, it is necessary that we have adequate international supplies of it.

The INRA and Supply Availability

The United States benefits from participating in INRA through its provisions which seek to assure adequate supply availability of natural rubber. These provisions include article 42, which states that "exporting members to the fullest extent possible undertake to pursue policies and programs which maintain continuous availability to consumers of natural rubber supplies." In addition, article 44 would allow consultations on government policies which affect the supply of natural rubber. As an importing country, the United States could initiate such talks at any time. Further, INRA can fund or help promote R&D projects that can help increase natural rubber supply. Obtaining such beneficial supply availability provisions were instrumental objectives for the United States in negotiations on INRA.

These supply assurance provisions are particularly useful when one considers the very important role that producer government policies have played in natural rubber production, investment, and trade. For example, Malaysia, Indonesia, and Thailand, which account for 76 percent of world natural rubber output and 88 percent of net exports, attempted to set up a cartel in the late 1970's, i.e., before INRA. Although such attempts will not succeed in the long run, they can seriously disrupt the world market. The INRA, which is strongly supported by these three countries, provides an alternative to any such efforts.

Positive steps have also been taken by producers during INRA I to make their own policies more market oriented. For example, before INRA 1979, Malaysia, Indonesia, and Thailand had very high and progressive export taxes on natural rubber. This concern was expressed by our industry during the ratification hearings for

the first agreement. We brought these concerns to the attention of INRA members. In the last few years, these export taxes have decreased significantly.

World natural rubber production performed well under the first agreement. There have been no supply shortages or disruptions since the agreement began. (However, the AIDS problem has led to a recent jump in prices for latex which, for practical reasons, cannot be stored in a buffer stock.) The average annual growth rate of world natural rubber output was higher during the 7 years of INRA than during the 7 years prior to the agreement—3.4 percent vs. 1.9 percent. Further, world natural rubber production steadily increased each year during the agreement, despite the severe recession in 1981–82. (In contrast, world natural rubber output decreased during the pre-INRA recession of 1974–75.)

The added assurance of a floor on prices has given producer governments a reason to promote and maintain natural rubber output even during recessions. This "safety net" aspect of the agreement is clearly beneficial to the United States in securing continuous supplies of this needed commodity.

Price Stabilization

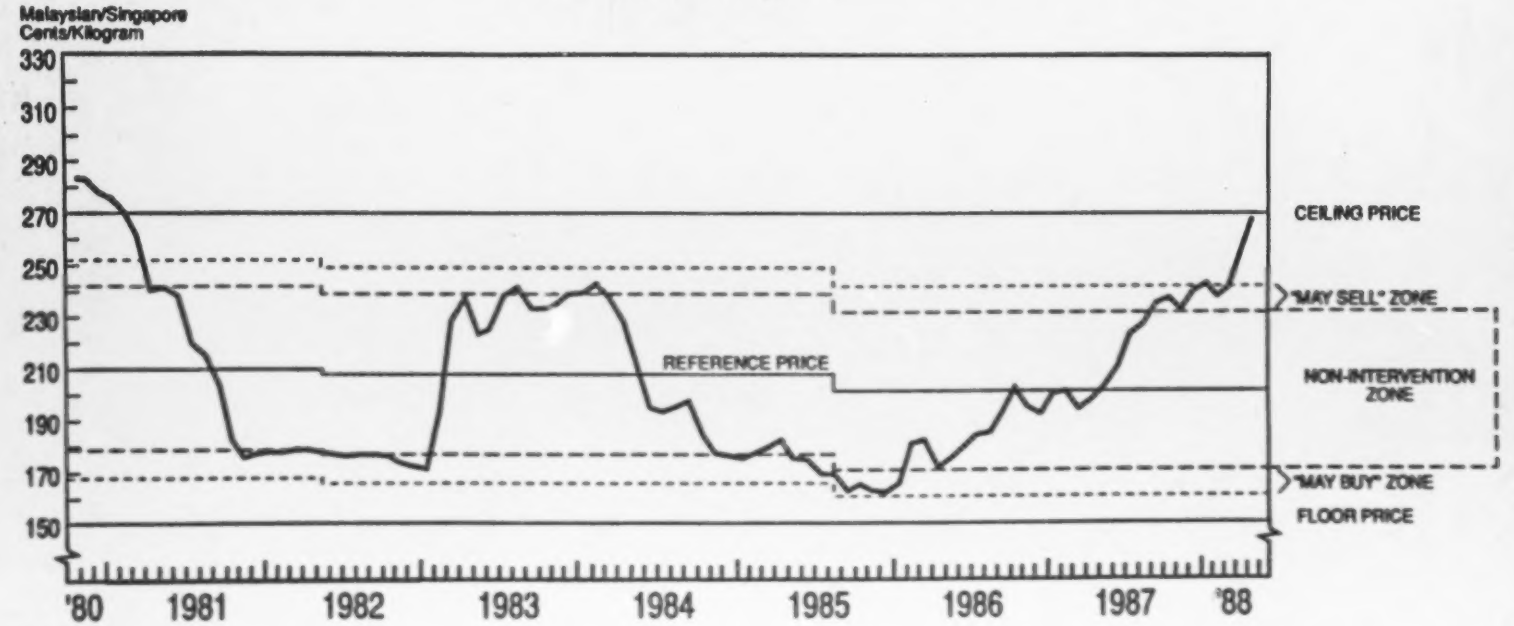
Supply assurance is also enhanced by stabilization of natural rubber prices, the main goal of the agreement. With a more stable price, producers perceive less risk and are more apt to invest in natural rubber, rather than alternative crops like palm oil. This leads to increased natural rubber output, which benefits consumer countries such as the United States. In fact, producer country negotiators during negotiations for the first INRA repeatedly stressed that assurance of a more stable price was essential to the development of policies to increase supply.

Aside from increased supplies, the U.S. industry prefers a stable natural rubber price per se. Natural rubber is a key input for certain large U.S. industrial users. Clearly, these companies' planning can be made more difficult by volatility and uncertainty in the prices of their major inputs such as rubber.

The first rubber agreement helped reduce the level of price instability that would have occurred if there had been no INRA. Buffer stock purchases began in November, 1981 and the buffer stock eventually rose to about 370,000 metric tons in 1985. After remaining around that level until September, 1987, the first sales of rubber from the buffer stock began and have continued at a brisk pace. It is very likely that all the rubber will be sold within the next few months. Buffer stock purchases kept the market price from falling below INRA's floor price during the severe 1981–82 recession, and sales kept prices below INRA's ceiling price until very recently when buffer stocks were run down. During the interim, prices were maintained close to INRA's reference price, which reflects the long-term market trend. In fact, for over half of the time during 1981–88, the price of rubber was in the "non-intervention zone" of the INRA price range, indicating a significant amount of price stability. During those times since 1981 when the price was outside of this zone, it was usually not far above or below it.

Chart 1 depicts the price of rubber from 1981–88 in relation to the INRA price range. Just below the graph is listed the amount of net purchases (or sales) from the buffer stock during each year. Price movements seemed to have been closely associated with buffer stock intervention.

Chart 1: World Rubber Prices and Buffer Stock Transactions,
October, 1980 - May, 1988



Annual Buffer Stock Net Purchases (+) or Sales (-)	+50,312 MT	+209,825 MT	+13,244 MT	+1,270 MT	+100,364 MT	+4,813 MT	-75,240 MT	-225,000 MT (Estimated net sales from Jan- May)

During the recession in late 1981-early 1983, the price of natural rubber fell into INRA's buying range as there was excess supply on the world market. Buffer stock purchases during this period totaled 270,000 metric tons in an attempt to put world rubber supply and demand more into balance. In early 1983 prices rebounded and for most of that year and 1984, they remained in the "nonintervention zone" of the price range. Two different econometric studies of the world rubber market suggest that these 1981–83 buffer stock purchases prevented rubber prices from falling further during this period. For instance, U.S. Department of Commerce econometric analysis suggests that the low rubber prices of 1982 would have been about 18 percent lower (i.e., probably below INRA's floor price) if there had been no buffer stock purchases. Dutch economists Kees Burger and Hidde Smit also found in their econometric research that the rubber market price would have likely gone below the floor price in 1982 had there been no buffer stock intervention.

In 1985 world surpluses of natural rubber had accumulated, as supply grew faster than demand. Prices had fallen and for most of that year were in the "may buy" zone. In 1985 about 100,000 metric tons were purchased for the buffer stock to keep world surpluses from building. Burger's and Smit's results suggest that these purchases reduced the level of price instability in 1985. Prices subsequently increased and during most of 1986 through August, 1987 they were again in the nonintervention zone. Last September, sales from the buffer stock began, as the price rose into INRA's "may sell" zone. Prices have generally been at or above that level since then, and buffer stock sales are reported to be in excess of 300,000 metric tons since last September. (The present level of the buffer stock is likely less than 70,000 metric tons and may reach zero soon.) Although rubber prices have reached high levels in 1988, it is probably too early to tell how effective the buffer stock sales have been in ameliorating this bull market. However, the apparent consensus of rubber market experts is that rubber prices since September would have been considerably higher, had these sales not occurred. This is the desired effect.

In summary, the evidence leads us to believe that buffer stock purchases and sales from 1981 to present have achieved INRA's objective of mitigating and dampening rubber price fluctuations.

Administration Position

The major reason for administration support is INRA's proven ability to provide substantial foreign policy and economic benefits to the United States. It has proven able to adjust to changing long-term market trends. As pointed out above, the price range has been adjusted in the past to reflect changing market conditions and the new agreement provides for automatic adjustments in the future.

The rubber agreement has worked in a balanced fashion between producers and consumers. INRA has both bought and sold natural rubber. 1981–85 was a period of net buffer stock purchases. Since September, 1987, sales have occurred and the buffer stock may

reach 0 metric tons soon. Thus, the rubber agreement has worked to stabilize prices on both the high and low sides.

The agreement has also been financially viable. The United States disbursed $53 million to pay for our share of rubber purchases and operating costs of the first agreement. We expect that at the beginning of the second agreement, however, our share of INRA's assets will be worth about $59 million. Thus, the value of our contribution or assets will have actually increased. This occurred because (1) INRA's financial assets earned interest income, and (2) the roughly 370,000 metric tons of rubber which were bought years ago at a low price are now being sold at a much higher price.

Further, we expect that our financial assets in INRA I (an estimated $59 million) will be sufficient to cover U.S. financial obligations for our membership in the second agreement. Thus, we do not foresee a need for additional financial resources in joining INRA II.

Conclusion

In conclusion, I would like to reiterate that INRA 1979 has served U.S. foreign policy as well as economic interests in terms of supply availability and rubber price stabilization. The first agreement has worked well. It has been financially sound and balanced between producer and consumer country interests. We expect the same from INRA 1987.

Thank you for the opportunity to present this statement in support of the administration's request for ratification of the second International Natural Rubber Agreement.

Entry Into Force

This agreement shall enter into force provisionally when Governments accounting for at least 75 percent of net exports (as detailed in Annex A of the agreement) and 75 percent of net importers (as detailed in Annex B of the agreement) have deposited their instruments of ratification. As of July 31, 1988, 20 countries had signed the agreement and five countries had ratified it.

Text of Resolution of Ratification

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the International Natural Rubber Agreement, 1987, done at Geneva, March 20, 1987, and signed on behalf of the United States on August 28, 1987.

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